

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

74 2280

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 74-2280

COLONIAL REALTY CORPORATION,

Plaintiff-Appellant,

-against-

JOHN MacWILLIAMS, JR., JAMES E. BRENNAN
and COLONIAL PENN GROUP, INC.,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANTS-APPELLEES
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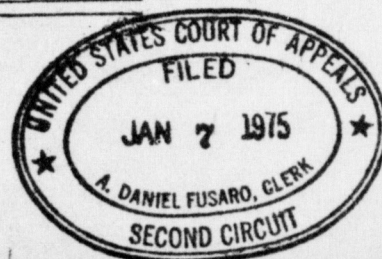


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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
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BRIEF FOR DEFENDANTS-APPELLEES
MacWILLIAMS and BRENNAN

Plaintiff has appealed from the decision of the district court (Gurfein, J.) reaffirming the nineteen-year-old rule enunciated in Stella v. Graham-Paige Motors Corp., 132 F. Supp. 100 (S.D.N.Y. 1955), remanded on other grounds, 232 F.2d 299 (2d Cir.), cert. denied, 352 U.S. 831 (1956), fixing the limits of the statutory time period for the imposition of liability under Section 16(b) of the Securities Exchange Act of

1934 (the "Act"). Plaintiff is asking this Court to overrule a decision which has stood unchallenged for almost two decades, which is cited as a statement of the controlling law by every commentator, and which has been relied on by investors in ordering their transactions so as to avoid violating Section 16(b).

QUESTION PRESENTED

Is a corporate officer or director liable under Section 16(b) of the Act for profits derived from a sale of his company's stock on January 1 and a subsequent purchase on June 30, or transactions consummated on similarly paired dates?

STATEMENT OF THE CASE

This action was brought under Section 16(b) of the Act to recover alleged profits received by defendants MacWilliams and Brennan. The court below, granting defendants' motion to dismiss for failure to state a claim, ruled that the transactions referred to in the complaint had not occurred "within any period of less than six months" and that, therefore, no liability attached under Section 16(b).

The complaint alleges that defendant MacWilliams, while an officer of Colonial Penn Group, Inc. ("CPG"), sold 50,000 shares

of that company's stock on December 20, 1972, and purchased 45,000 shares on June 19, 1973. It is also alleged that defendant Brennan, while an officer of CPG, sold 4,000 shares of CPG stock on December 22, 1972, and purchased 5,000 shares on June 21, 1973 (A-2, A-3). These transactions were held by Judge Gurfein to be outside the purview of Section 16(b)(A-6).

POINT I

THE NEED FOR PREDICTABILITY IN COMMERCIAL AND FINANCIAL TRANSACTIONS COMPELS ADHERENCE TO STARE DECISIS IN THIS CASE

Section 16(b) provides, in pertinent part:

. . . any profit realized by [an officer of an issuer] from any purchase and sale, or any sale and purchase, of any equity security of such issuer. . . within any period of less than six months, . . . shall inure to and be recoverable by the issuer. . . . 15 U.S.C. §78p(b) (Emphasis and bracketed material added.)

The meaning of the phrase "within any period of less than six months" was settled by the decision in Stella v. Graham-Paige Motors Corp., 132 F. Supp. 100 (S.D.N.Y. 1955), remanded on other grounds, 232 F.2d 299 (2d Cir.), cert. denied, 352 U.S. 831 (1956). In that case Judge Dimock decided the precise question at issue here: What is the earliest date on which a subsequent sale (or purchase) may be made without liability under Section 16(b)?

He wrote:

Graham-Paige [the defendant] argues that this language means that in order that any profit realized be recoverable by the issuer both the "purchase" and the "sale" must occur within a period of less than six months. I agree. That is exactly what the statute says.

Graham-Paige contends that the "purchase" and the "sale" here did not both occur within a "period of less than six months". If that is so I shall not need to decide whether or not Graham-Paige realized a profit. As part of its argument Graham-Paige construes the words "period of less than six months" to mean a period the first and last days of which each include the twenty-four hours from midnight to midnight, and the last day of which is the second day prior to the date corresponding numerically to that of the first day of the period in the sixth succeeding month. For example, the period from and including January 1st to and including June 29th would be a "period of less than six months" but the period to and including June 30th would be a period of exactly six months. Thus profit realized from a purchase on January 1st and a sale on June 30th would not be recoverable under the statute.

That construction is correct. 132 F. Supp. at 103-04. (Emphasis and bracketed material added.)

The court found that the purchase by defendant Graham-Paige had occurred on February 10, 1947, and added that "to come within the same less-than-six months' period with the purchase, therefore, the sale would have to have taken place on or before August 8, 1947." 132 F. Supp. at 105.

The Court of Appeals concurred, saying that "we agree with the trial judge that the purchase of the stock occurred on February 10, 1947, and that therefore sales made before August 8, 1947 were within the statutory period." 232 F.2d at 301.

Judge Gurfein found that "the sale/purchase dates of both MacWilliams' and Brennan's transactions (Dec. 20/June 19 and Dec. 22/June 21, respectively) are patterned exactly after the formulation in Stella." 381 F. Supp. 26, 28 (S.D.N.Y. 1974) (A-8). Accordingly, following Stella, he granted defendants' motion to dismiss the complaint for failure to state a claim.

Plaintiff's briefs, in both this Court and the court below, have revealed no case in which the rule of Stella has been questioned by any court, nor any case in which Section 16(b) liability has been found with a pairing of dates equivalent to the pairing presented here. To the contrary, the rule enunciated in Stella has been adopted by the Court of Appeals for the Ninth Circuit -- the only other circuit in which this question has been considered.

In Rheem Manufacturing Co. v. Rheem, 295 F.2d 473, 475 n. 3 (9th Cir. 1961), the court felt that no more than a footnote was required to recall the rule of Stella.

If this finding [purchase on June 5, 1958] is correct, the earliest sale of shares, on December 4, 1958, would not be "within any period of less than six months" from the acquisition and hence not within the statute. [Citing Stella.]

The commentators on federal securities law have been equally unanimous in citing Stella as controlling authority. Professor Loss expresses no doubt with respect to the length of the statutory period. Citing only one case, Stella, he writes:

Since the statute refers to "any period of less than six months," the profit realized from a purchase on January 1 and a sale on June 30 would not be recoverable.

2 L. Loss, Securities Regulation 1058 (2d ed. 1961), as revised by 5 L. Loss, Securities Regulation 3021-22 (1969 Supp.) Accord, R. Jennings and H. Marsh, Securities Regulation 1307 (3d ed. 1972); Comment, "Section 16(b): An Alternative Approach to the Six-Month Limitation Period," 20 U.C.L.A. L. Rev. 1289, 1294 n. 26 (1973); H.S. Bloomenthal, Securities and Federal Corporate Law 10-18 (1972); S. Goldberg, SEC Trading Restrictions and Reporting Requirements for Insiders 107 (1973).

It is fundamental that, absent a clear showing of error in the prior decision or a showing of changed circumstances, courts should adhere to precedent. This is especially

true in cases such as this where certainty and the ability to rely on established rules are necessary for the orderly planning and implementation of financial transactions.

Certainty in law is not, of course, the only value to be considered in the judicial process. But in construing the technical phrase "within any period of less than six months" as it appears in Section 16(b), no other value is present. In terms of policy or jurisprudence it simply does not matter whether a "period of less than six months" runs from January 1 through June 29 or through June 30. What does matter is that once the rule has been stated, and cited as controlling authority for nineteen years, it not be changed.

We submit that the rule of Stella fixes the time period under Section 16(b) and that no court and no commentator have ever challenged that decision. Any corporate officer seeking to ascertain the first date on which he may permissibly make a subsequent sale (or purchase) will find reference to only one case, Stella v. Graham-Paige Motors Corp., in any of the legal research tools that he might consult.*

* In addition to the sources noted at p. 6, supra, such tools include 15 U.S.C.A. § 78p(b) n. 56 at 129-30 (1971); 2 CCH Fed. Sec. L. Rep. ¶26,101.60 at 19,144 (1973); 12 Mod. Fed. Pract. Dig. Corporations § 316(3) at 209 (1960); Mod. Fed. Pract. Dig. Cum. Supp. Securities Regulation § 109 at 525 (1973); Shepard's Federal Citations of Fed. Supp. 462 (6th ed. 1969); 32 Words and Phrases 87 ("Period of less than six months") (1956).

The transactions of defendant MacWilliams and Brennan match exactly the dates approved as outside the statutory period by the court in Stella. Having meticulously ordered their transactions so as to fall outside the statutory period, as defined in the only case to have considered it, these defendants should not be penalized.

We believe that Stella was correctly decided. But equally important, the construction of the Congressional language "within any period of less than six months" is the archetypal case for the application of Justice Brandeis' celebrated statement in Burnet v. Coronado Oil & Gas Co., 285 U.S. 393, 406 (1932):

Stare decisis is usually the wise policy, because in most matters it is more important that the applicable rule of law be settled than that it be settled right.

POINT II

THE COURT IN STELLA CORRECTLY
CONSTRUED THE PHRASE "WITHIN ANY
PERIOD OF LESS THAN SIX MONTHS"

As Judge Dimock in Stella viewed the statutory language of Section 16(b), a period of six months begins on January 1 and ends at midnight on June 30. A period of "less than six months" ends one day earlier, i.e., at midnight on June 29. A purchase on January 1 and a sale on June 29 would,

therefore, fall within the statutory period which triggers liability under Section 16(b). We submit that Judge Dimock correctly described the statutory period.

The statutory language "within any period of less than six months" contains two crucial phrases -- the phrase "within any period" and the phrase "less than" -- which compel the decision reached in Stella.

Of paramount importance in analyzing the phrase "within any period of less than six months" as used in Section 16(b) is the recognition that the two events which give rise to statutory liability -- a purchase and a sale (or a sale and a purchase) -- must both occur "within" the time period. The time period itself must, therefore, be defined in a manner so as to include the two events; otherwise, the two events will not have both occurred within the period. Plaintiff, however, contends that in computing the statutory period for a transaction which occurred on January 1, the first day counted should be January 2. Plaintiff would therefore have this Court treat the day after the occurrence of the event (sale or purchase) as the first day of the period -- in other words, a purchase or sale which must occur within a certain period would be treated as happening before the period begins. But we agree with Judge Dimock that there can be no such thing as a purchase "within" a period that did not start

until after the purchase. (132 F. Supp. at 104). Even legal fictions are not that fictitious!

Plaintiff's position that the day on which the first of the two events occurred should be eliminated in measuring the statutory period also leads to the incongruous result that a single year of 12 months would not be long enough to contain two mutually exclusive six-month periods. A six-month period commencing January 1 must, therefore, end at midnight on June 30.

The phrase "less than" is no less important than the phrase "within any period" in defining the Section 16(b) period. Since a six-month period which begins on January 1 must end at midnight on June 30, a less-than-six-month period which begins on January 1 must end at midnight on June 29. Congress could have chosen a statutory period of six months, but it did not. It chose instead a period of "less than" six months. To say, as plaintiff asserts, that a period of six months and a period of less than six months, both of which begin on January 1, also both end on June 30, is nonsense and makes the words "less than" meaningless. Judge Dimock's ruling in Stella gives meaning to these words.

In support of its assertion that Stella was incorrectly decided, plaintiff has analogized the measurement of time in other contexts to the measurement of time in the context of Section 16(b). Resort to rules of measurement developed

for use in other situations to attack the analysis in Stella is misguided, and is particularly unhelpful when the wording of those other rules is so different from the wording of Section 16(b).^{*} Indeed, one federal district court has flatly rejected such analogies as "wholly unrelated" to Section 16(b):

The legal rules which have developed for determining when a contract offer has been accepted, or when statutory or insurance notices have been effectively given or when short versus long term capital gains are earned for tax purposes are premised on considerations wholly unlike those which Congress was concerned with in enacting §16 of the Securities Act. For this reason the court declines to adopt any of these three rationales in determining when the stock options in question were exercised. Lewis v. Dwyer, 365 F. Supp. 607, 608-09 (D. Mass. 1973).

But even assuming their relevance, the authorities cited by plaintiff in these unrelated fields are not, in fact, inconsistent with the court's analysis in Stella. Relying on the same cases distinguished by Judge Dimock in 1955, plaintiff argues that the date of the initial purchase is excluded

* "The tendency to assume that a word which appears in two or more legal rules, and so in connection with more than one purpose, has, and should have precisely the same scope in all of them, runs all through legal discussions. It has the tenacity of original sin and must constantly be guarded against." Cook, Logical and Legal Bases of the Conflict of Laws 159 (1942). Cited with approval, Civil Aero Bd. v. Delta Airlines, Inc., 367 U.S. 316, 328 (1961).

from the statutory period of Section 16(b). It is true that cases such as Cornell v. Moulton, 3 Denio (N.Y.) 12, 15 (1846), Sheets v. Selden's Lessee, 2 Wall. (69 U.S.) 177, 190 (1865) and Burnet v. Willingham Loan & Trust Co., 282 U.S. 437, 439 (1931), hold that in measuring time from a particular day or event, the day on which the event happened may be excluded from the computation. However, these cases all speak of measuring time "from," "after" or "before" the one event or day in question. In sharp contrast, Section 16(b) requires one to fix the time of happening of two events within a time period which is defined only in relation to, and which must include, those two events. Thus, plaintiff's citations offer no assistance in describing the time period set forth in Section 16(b).

Plaintiff also argues that the last day of a six-month period is included within that period. We do not disagree. June 30 is the last day of a six-month period beginning on January 1 and June 29 is the last day of less than a six-month period beginning on January 1. But plaintiff then goes on to assert that a sale on June 30 any time prior to midnight would also be within less than six months. To reach this result, plaintiff must attack the rule that the law ignores fractions of a day. Yet the very cases plaintiff relies on make it clear that the law treats days as indivisible. For example, in Greulich v. Monnin, 142 Ohio St. 113, 50 N.E.2d

310, 312, 149 A.L.R. 477 (1943), the Supreme Court of Ohio stated the "well settled general rule" that "[f]ractions of a day are not generally considered in the legal computation of time. . . ." Although this general rule will yield to strong contravening considerations, such as the necessity of determining conflicting rights which depend upon priority in time within a single day,* none of the reasons for recognizing fractions of a day is present here. Plaintiff has offered no justification for noting the exact hour and minute of a sale or purchase of securities and we submit that any requirement of such notation for purposes of Section 16(b) would only lead to confusion and unnecessary complexity.

Most importantly, acceptance of plaintiff's position, as noted above, would render the words "less than" in the phrase "within any period of less than six months" a nullity. If a sale at any time prior to midnight on the last day of a six-month period led to liability under Section 16(b),

* The necessity of ascertaining the order of events was the specific reason why the courts in Louisville v. Portsmouth Savings Bank, 104 U.S. 469 (1881) and In re Gubelman, 10 F.2d 926 (2d Cir. 1925), rev'd in other respects, 275 U.S. 254 (1927), chose to recognize fractions of a day. For example, in Louisville v. Portsmouth Savings Bank the Supreme Court looked to fractions of a day in order to find that township bonds issued pursuant to the vote cast in a township election at 9 a.m. on July 2, 1870, were not invalidated by a provision of the Constitution of the State of Illinois prohibiting such bonds, when the Constitution was not adopted until sunset on July 2, 1870.

then no sale could be made on that day. This result would make a period of "less than six months" identical to a period of "six months." To give effect to the words "less than" in the statute, such an interpretation must be rejected as it was in Stella.

Plaintiff has cited several other authorities in support of its view that the statutory period runs for what it has denominated a "full six months" (Br. p. 18).^{*} In none of the cases cited was the precise measurement of the statutory period an issue which required careful resolution. The language quoted by plaintiff from other Section 16(b) cases is most aptly characterized as loose or shorthand renditions of a statutory phrase which is clumsy to use and repeat in haec verba. Moreover, as one would expect, such loose language appears only in cases in which the boundaries of the statutory period were not in issue. In B. T. Babbitt, Inc. v. Lachner, 332 F.2d 255 (2d Cir. 1964), the only case cited in which dates did affect the outcome, the Court of Appeals was required only to undo the district court's glaringly improper pairing of transactions (November 5 -- May 6).

^{*} Plaintiff misquotes the statute by periodic reference to a "full six months." That the statute in fact refers to a period of "less than six months" is, of course, central to this case.

Similarly, plaintiff's references to the legislative history of the Act and SEC rules relating to other aspects of the statute are of no help in construing the phrase "within any period of less than six months." Examination of the passages cited by plaintiff plainly reveals that none of these authorities were concerned with or focused on the precise boundaries of the statutory period. Certainly this case is one calling for the application of Justice Frankfurter's maxim, "when the legislative history is doubtful, go to the statute." Greenwood v. United States, 350 U.S. 366, 374 (1956).

We think that the decision in Stella is correct. At the very least, however, as Judge Gurfein pointed out below, "[m]ost importantly, the Stella formulation is by no means clearly in error" (A-8). Under these circumstances, settled law should not be disturbed.

CONCLUSION

Plaintiff is asking this Court to reverse a nineteen-year-old rule addressed to one of the narrowest and least significant issues that could possibly be raised under the federal securities laws. Having once been decided, and subsequently relied on by investors, the decision in Stella should not be disturbed.

The judgment of the district court should be affirmed.

Dated: January 7, 1975

Respectfully submitted

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